



COUNCILMEMBER CARL DEMaIO

FIFTH DISTRICT

CITY OF SAN DIEGO

MEMORANDUM

DATE: August 20, 2009

TO: Honorable Mayor Jerry Sanders
Tony Young, Budget and Finance Committee Chair

FROM: Councilmember Carl DeMaio *Carl DeMaio*

RE: Recent Court Ruling on City Business and Rental Tax Programs

In January, I issued the attached memo proposing reform of the Business Tax Certificate and Rental Unit Business Tax programs.

Two days ago, the Fourth Appellate District Court of Appeal decided that the fee charged to administer the Rental Unit Business Tax is "a general tax that is void because it was not approved by a majority vote of the municipal electorate as required by...the California Constitution."

In short, the court struck down the city's practice of charging a fee on top of a tax. As an example, in FY 2008, the city collected \$2.7 million in processing fees, with total Business and Rental Tax program revenue amounting to nearly \$17 million. This ruling may force the city to issue refunds for the processing fees collected since 2004.

In light of this development, I would request the following:

- The Budget and Finance Committee consider the issue of reforming this program, including, but not limited to the points laid out in my January memo.
- The Mayor report on the fiscal impact of the court's decision to the FY 2010 budget and beyond.

I appreciate your consideration of my request. Please contact my office if you have any questions.

CC: Mayor Jerry Sanders
City Councilmembers
Andrea Tevlin, Independent Budget Analyst



City of San Diego

CARL DEMAIO
CITY COUNCILMEMBER—DISTRICT 5

MEMORANDUM

DATE: January 12, 2008
TO: Mayor and City Council
CC: City of San Diego's Small Business Advisory Board
FROM: Councilmember Carl DeMaio *Carl DeMaio*
RE: Small Business Tax and Regulatory Relief Proposals

During this time of economic downturn, the City of San Diego ought to do everything it can to support local job creation and retention—particularly in the self-employment, real estate, and small business sectors of the local economy. I appreciate that the Mayor and my colleagues on the City Council share this goal.

I'd like to draw your attention to complaints my office has received regarding the city's **Business Tax Certificate** and **Rental Unit Business Tax** programs. Due to new data-sharing approaches being used by the City Treasurer, thousands of San Diegans are being sent delinquency notices—complete with late fees, penalties, and surcharges. (See Attachment 1)

While I recognize the need for compliance enforcement by the City Treasurer, the challenging economic climate has led me to suggest that the Mayor and City Council review these two programs for possible reform—with some measure of tax relief enacted on or before April 15, 2009. Reforming these two tax requirements would be part of a broader four-point Small Business Tax and Regulatory Relief Proposal that includes 1) Tax Relief, 2) Compliance Education and Outreach, 3) Public-Private Partnerships, and 4) Regulatory Relief.

The **Business Tax Certificate** impacts anyone engaged in a business activity within city limits—including self employed individuals and independent contractors. Approximately 75,000 certificate holders are small businesses alone, comprising 92% of all certificate holders in San Diego. As some San Diegans are laid off from larger corporations, many are turning to self-employment to make ends meet—requiring them to pay this tax.

The **Rental Unit Business Tax** is imposed on anyone who owns, operates, or manages the rental of any residential real estate. The local real estate market is under significant distress with many property owners facing negative equity and struggling to make mortgage payments.

In FY 2008, the Business Tax Certificate and the Rental Unit Business tax jointly netted \$16.8 million in revenue.

Element 1: Tax Relief Options

During the 1990's the City of San Diego committed to eliminate its business taxes—but succeeded only in cutting them. Given the city's fiscal challenges the Mayor and City Council may not be in the position to eliminate the entire tax at this time.

However, I believe we can focus our tax relief to assist bona fide *new* small business as well as reduce some of the penalties and late fees being imposed on recently started businesses that were unaware of the tax requirement. We may also be able to provide relief to individuals who are newly self-employed or are independent contractors.

In reviewing different options for reform, the San Diego Institute for Public Policy Research provided my office two models used by other cities:

In 2005 Anaheim Mayor Curt Pringle established a 100 day "business tax holiday," waiving the business license tax from new businesses that registered with his city. The effort proved fruitful; more than 2,000 new businesses were formed within the three and a half month holiday, a 33% increase from the same time length the prior year. Mayor Pringle also included a tax amnesty provision in his holiday initiative, which 550 enterprises ultimately participated in, receiving a waiver from costly late fees, back taxes, and additional interest rate penalties.

Los Angeles has also successfully implemented such programs, hosting at least three license amnesty initiatives in the last fifteen years, including a 2001 program that yielded more than \$14 million in tax revenue and a six month tax amnesty that netted \$5 million in 2002. Now facing a \$440 million budget deficit, Los Angeles Mayor Villaraigosa is pressing for a new business tax amnesty that is projected to haul in approximately \$5 million beginning this fiscal year.¹

A properly structured tax relief package can actually bring in more revenue for the city (as Los Angeles anticipates) or be revenue neutral (as has been Anaheim's experience.) The City Treasurer has identified **23,290** potentially unregistered accounts that could be collected during a well-publicized Tax Amnesty/Holiday period. Tax relief can have a positive impact short term for effected small businesses, while generating more revenue for the city over the long term through expanded enrollment in the Business Tax Certificate program.

¹ Vince Vasquez, San Diego Institute for Public Policy Research

Working with the Mayor's office, my office will examine and report back to the City Council on pros and cons of the following options:

- Elimination or reduction of elements of the Business Tax Certificate
- Tax Holiday (Limited Period)
- Tax Amnesty (Partial or Full)
- Exemption of self-employed and independent contractors (short term or permanent)

For your review, below is the breakdown of a typical liability statement being sent to small businesses. The city's efforts to collect unregistered accounts netted roughly \$2.5 million in revenue last year—with \$915,000 in late fees and \$324,000 in surcharge penalties. (See Attachment 2)

Sample FTB Tax Liability Statement						
	2005	2006	2007	2008	Additional Fees	Total
Business Tax	\$34.00	\$34.00	\$34.00	\$34.00		\$136.00
Late Fee*	\$50.43	\$40.92	\$32.49			\$123.84
Zoning Fee					\$17.00	\$17.00
Non-Compliance Surcharge	Not assessed if taxpayer responds within thirty (30) days.					
Processing Fee					\$25.00	\$25.00
TOTAL:	\$84.43	\$74.92	\$66.49	\$34.00	\$42.00	\$301.84

***Waived in a Tax Amnesty Proposal**

Element 2: Compliance Education and Outreach

The City of San Diego—to the credit of the Treasurer's office—has become very good at its compliance enforcement for the Business Tax Certificate and the Rental Unit Business Tax. For example, the state's AB63 Local Government Sharing Program has allowed the city to access tax records from the state's Franchise Tax Board—thus increasing the number of individuals being fined. For the Rental Business Tax, the City has made aggressive use of data from the County Assessor's office—using discrepancies in mailing addresses vs. property addresses to flag individuals possibly subject to the tax.

While the enforcement efforts of the city are commendable, the city should be as aggressive in its public education and outreach efforts. Consistent with that, I am asking the City Treasurer to devise an outreach campaign which would, at the least, include working with City TV to create a 5 minute PSA that could run on the city channel for the purpose of educating the public on the requirements of the two taxes.

In addition, my City Council office will be working with Business Improvement Districts, local business groups, civic groups and other organizations to raise awareness of the tax programs. We stand ready to help other Council Offices with their outreach efforts as well.

Element 3: Public-Private Partnerships

In conjunction with its Tax Amnesty and Tax Holiday initiatives, the City of Anaheim utilized several partnerships to support their small businesses. One partnership with the Anaheim Chamber of Commerce provided free memberships to new small businesses where they could access a wide array of support services. In addition, the local utility in Anaheim waived their initial hook-up fees. These kinds of partnerships can have a significant impact on helping small businesses succeed in their first year of operation.

I'm pleased that the North County Chamber of Commerce has agreed to participate in such a program for small businesses operating within District 5. To take advantage of this offer, a formal linkage between the Business Tax Certificate program and this Chamber is now needed.

I'd like to request that the City's Small Business Advisory Board study and recommend additional partnerships that could be formalized between the city and outside groups. As small businesses enroll in our Business Tax Certificate program they would be referred to these supporting partners for free or discounted assistance in getting started with their business activities.

Element 4: Regulatory Relief Proposals

During the 1990s, the Mayor and City Council convened several public hearings for the sole purpose of receiving complaints and suggestions from city small businesses on how to make San Diego more business friendly. Unfortunately, the last such day was held in 1998—and the city is long overdue for another listening session. Working with the City's Small Business Advisory Board and other interested parties, the City Council should organize another "Regulatory Relief Day" in 2009 to review possible reforms.

During these tough economic times, I believe that the City of San Diego can and should do more to help small businesses and the self-employed. Given the significant level of complaints received regarding the Business Tax Certificate and the Rental Unit Business Tax programs, I am convinced we can operate these two programs in a more jobs-friendly and service-oriented way. I look forward to working with the Mayor and City Council to achieve improvements on these issues.